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In The

# Supreme Court of the United States

October Term, 1990

STEPHEN J. BALLAY, *et al.*,

*Petitioners,*

*vs.*

LEGG MASON WOOD WALKER, INC.,

*Respondent.*

*On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit*

## RESPONDENT'S BRIEF IN OPPOSITION

C. CLARK HODGSON, JR.
*Counsel of Record*
DAVID C. FRANCESKI, JR.
KEITH R. DUTILL
STRADLEY, RONON, STEVENS
& YOUNG
*Attorneys for Respondent*
2600 One Commerce Square
Philadelphia, Pennsylvania 19103-7098
(215) 564-8000

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## QUESTION PRESENTED

Whether Section 12(2) of the Securities Act of 1933, which makes a person who offers or sells securities in an initial distribution liable for misstatements in a "prospectus or oral communication", should be expanded to misstatements made in secondary market transactions.[1]

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1. Petitioners contend that this case also presents the question whether Section 10(b) of the Securities Exchange Act of 1934 offers the exclusive federal remedy for misstatements in the secondary securities market. Although the opinion of the Court of Appeals addresses the evisceration of Section 10(b) that would result from expanding Section 12(2) to secondary market transactions, the court did not hold that the remedy offered by Section 10(b) is exclusive. Accordingly, the second question enumerated in the Petition would not be before this Court if it were to review this case.

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## RESPONDENT'S BRIEF IN OPPOSITION

## COUNTERSTATEMENT OF THE CASE

Petitioners are John Burke, a former broker and branch manager at Legg Mason Wood Walker, Inc.[2] ("Legg Mason"),

2. Legg Mason, Inc. is the parent corporation of respondent Legg Mason Wood Walker, Inc. The latter has no subsidiaries which are not wholly owned.

and forty-one of Burke's customers (collectively "the investors") who bought stock in Wickes Company, Inc. ("Wickes") at Burke's recommendation between June, 1986 and January, 1988 (R.153a). The investors did not buy Wickes stock as part of a distribution of securities; all bought Wickes in the secondary securities market. After the market price of Wickes had declined sharply and Burke had quit Legg Mason, he and his customers commenced an action to recover their trading losses.

From June, 1986 through December, 1987, as part of a routine service offered by most major brokerage firms, Legg Mason research analyst Anthony Pearce-Batten evaluated and reported on the common stock of Wickes (R.831a-832a). Batten's reports took a number of different forms, including: (a) periodic research reports and monthly updates (R.118a-152a); (b) oral reports to Legg Mason brokers in the course of telephone "squawk box" calls to the branch offices (R.484a-485a); and (c) individual conversations with Legg Mason brokers (R.742a). By August, 1987, Batten had written and Legg Mason had distributed more than one dozen reports on Wickes (R.496a, 846a-851a). These reports addressed a variety of issues, including, *inter alia,* Wickes' price history, earnings, net operating losses, debt, management and acquisitions (R.118a-143a, 998a-1003a).

The investors' claim against Legg Mason relates solely to an aspect of Wickes' worth known in the industry as book value. According to Burke, in reporting to his own Legg Mason brokers on the book value of Wickes, Batten mistakenly stated that it *ex*cluded goodwill when he should have said that it *in*cluded goodwill (R.488a). None of the investors other than Burke was privy to this alleged miscommunication (R.557a), and few would have understood it in any event (R.388a). In fact, Burke did not even discuss the book value of Wickes with most of the investors (R.387a). The error which Burke claims Batten communicated orally to the brokers as early as June, 1986, did not appear

anywhere in Batten's research reports until almost fourteen (14) months later, long after the vast majority of the investors had already purchased their shares of Wickes (R.557a). Furthermore, throughout this time period, the pertinent information regarding the book value and goodwill of Wickes was plainly and accurately set forth in the numerous publicly disseminated financial statements and corporate reports of Wickes (R.575a-576a).

At the close of the evidence at trial, the investors withdrew all counts of their complaint except those alleging liability under Section 12(2) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934. The trial court, having previously denied Legg Mason's pretrial motion to dismiss the Section 12(2) claim on the ground that the transactions enumerated in the complaint were not part of an initial offering, denied its motion for a directed verdict as well (R.823a-824a).[3] At the close of the liability phase of the trial, the jury returned a verdict in favor of Legg Mason on the Section 10(b) claim but found against Legg Mason on the Section 12(2) claim. Legg Mason's post-trial motions were denied. On appeal, the United States Court of Appeals for the Third Circuit affirmed the judgment entered in favor of Legg Mason on the Section 10(b) claim, reversed the judgment entered against Legg Mason on the Section 12(2) claim, and remanded the matter for entry of judgment in favor of Legg Mason on the investors' Section 12(2) claim. *Ballay v. Legg Mason Wood Walker, Inc.*, 925 F.2d 682, 695 (3d Cir. 1991).

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3. In denying Legg Mason's motion for directed verdict as to Section 12(2), Judge Weiner stated on the record:

> I don't disagree with you. I think that there is very little question about it. But just out of an abundance of caution, I'm not going to decide this case. I'm going to give it to the jury to decide.

(R.824a).

## SUMMARY OF ARGUMENT

Review by this Court is unwarranted. The holding below is the first and only appellate court decision respecting the applicability of Section 12(2) to secondary market transactions. The Court of Appeals' refusal to expand Section 12(2) beyond misstatements made in initial distributions conforms with the language and legislative history of Section 12(2) and follows the consensus developed in the district courts. It preserves the long-standing and well-developed right of investors who have been victimized by fraud in the secondary market to pursue their claims under Section 10(b) of the 1934 Act and the common law. Since the Circuits are not in conflict and the Court of Appeals has correctly interpreted Section 12(2), the petition should be denied.

## REASONS FOR DENYING THE WRIT

### I.

### THE DECISION OF THE COURT OF APPEALS IS THE FIRST AND ONLY APPELLATE COURT DECISION ON THE APPLICABILITY OF SECTION 12(2) TO THE SECONDARY SECURITIES MARKET.

As the Court of Appeals in this case specifically pointed out in reaching its decision, the question whether Section 12(2) applies to transactions in the secondary market was at the time "an issue not yet ruled upon by any federal appellate court." *Ballay*, 925 F.2d at 684. *See also, Hoxworth v. Blinder, Robinson & Co., Inc.*, 903 F.2d 186, 203 (3d Cir. 1990) (noting that as of May 9, 1990, "no Court of Appeals has decided this question" of whether Section 12(2) applies to after-market purchases). It is clearly the first and only appellate court decision on the issue. In an effort to create the appearance of a conflict among the Circuits where none exists, the investors argue that "several other

Circuit Courts have expressly stated that the protection afforded to investors by Section 12(2) applies to after market transactions" (Petition at 21), and in support of their position they primarily rely on several old and inapposite Circuit Court opinions. Their assertion is plainly wrong. No other Court of Appeals has ever decided the question whether Section 12(2) applies to secondary market transactions.

The first case cited by the investors in support of their conflict argument is the 1967 opinion of the Second Circuit in *Barnes v. Osofsky*, 373 F.2d 269 (2d Cir. 1967). The plaintiffs in *Barnes* sought recovery under Section 11 of the 1933 Act for misstatements and omissions in the registration statement and prospectus which had accompanied their initial offering purchases. *Id.* at 270. The sole issue before the court in *Barnes* was "whether the district court was right in ruling that *Section 11* extends only to purchases of the newly registered shares." *Id.* at 271 (emphasis added). Since the plaintiffs never argued, and the court never confronted, a Section 12(2) claim, the statement from *Barnes* relied on by the investors is pure dictum. Not surprisingly, the Second Circuit did not feel constrained by *Barnes* when, thirteen years later, in *Gross v. Diversified Mortgage Investors*, 431 F. Supp. 1080, 1095 (S.D.N.Y. 1977), *aff'd mem.*, 636 F.2d 1201 (2d Cir. 1980), it affirmed dismissal of a Section 12(2) claim on the ground that Section 12(2) "only protects persons buying the securities specified in the registration statement and prospectus." *See also, McCowan v. Dean Witter Reynolds, Inc.*, 1989 U.S. Dist. Lexis 3711 (S.D.N.Y., April 12, 1989) (joining the "chorus finding Section 12(2) inapplicable to post-distribution transactions"); *Strong v. Paine Webber, Inc.*, 700 F. Supp. 4, 5 (S.D.N.Y. 1988) (holding that Section 12(2) does not apply to trading in secondary market). No conflict exists between the Second Circuit and the Third Circuit on the applicability of Section 12(2) to secondary market transactions.

The investors also contend that the decision of the Court of Appeals conflicts with the Tenth Circuit holding in *Woodward v. Wright*, 266 F.2d 108 (10th Cir. 1959). In *Woodward*, the plaintiffs purchased an interest in an oil and gas lease in a private offering and subsequently sought to recover under Sections 12(1) and 12(2) on the ground that the offering prospectus contained misstatements and omissions. *Id.* at 113. In reversing the judgment entered in favor of the defendant on the Section 12(2) claim, the court in *Woodward* simply held that Section 12(2) applied to both private and public offerings of securities. *Id.* at 115-16. The opinion never mentions whether Section 12(2) applies to transactions in the secondary securities market.[4]

Finally, the vast majority of the district courts that have addressed the first question presented by the investors' petition agree with the Third Circuit. Legg Mason is aware of twenty-five (25) district court decisions treating the issue.[5] Of these, nineteen (19) have held Section 12(2) *in*applicable to post-distribution

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4. In footnote 16, petitioners cite, without explanation, three other cases in support of their claim that a conflict among the Circuits exists: *Short v. Belleville Shoe Mfg. Co.*, 908 F.2d 1385 (7th Cir. 1990), *cert. denied*, 1990 Westlaw 144029 (U.S. June 28, 1991); *Schillner v. H. Vaughan Clarke & Co.*, 134 F.2d 875 (2d Cir. 1943); *Cady v. Murphy*, 113 F.2d 988 (1st Cir. 1940), *cert. denied*, 311 U.S. 705 (1940). None of these cases discusses the applicability of Section 12(2) to transactions in the secondary market, and there is no indication that the issue was ever raised in any of the cases.

5. In addition to those cases cited by the petitioners at footnote 17, five other cases have held Section 12(2) inapplicable to secondary market transactions: *Pacific Dunlop Holdings, Inc. v. Allen & Co., Inc., et al.*, 1991 U.S. Dist. Lexis 6748 (N.D. Ill., May 15, 1991); *Bank of Denver v. Southeastern Capital Group, Inc., et al.*, 1991 U.S. Dist. Lexis 6452 (D. Colo., May 9, 1991); *Leonard v. Stuart-James Co., Inc., et al.*, 742 F. Supp. 653 (N.D. Ga. 1990); *Klein v. Computer Devices, Inc.*, 591 F. Supp. 270 (S.D.N.Y. 1984); *Gross v. Diversified Mortgage Investors*, 431 F. Supp. 1080 (S.D.N.Y. 1977), *aff'd*, 636 F.2d 1201 (2d Cir. 1980).

trading. Both district courts that have addressed the issue since the opinion of the Court of Appeals have specifically adopted its reasoning. *See Pacific Dunlop Holdings, Inc. v. Allen & Co., Inc., et al.*, 1991 U.S. Dist. Lexis 6748 (N.D. Ill., May 15, 1991) ("We are persuaded by the reasoning in *Ballay v. Legg Mason Wood Walker, Inc.* . . . and hold that Section 12(2) applies only to initial offerings and not to after market trading."); *Bank of Denver v. Southeastern Capital Group, Inc., et al.*, 1991 U.S. Dist. Lexis 6452 (D. Colo., May 9, 1991) ("After consideration of the statute and the cases interpreting it, I adopt the rule of the Third Circuit."). This Court should allow the consensus to continue to build, and intervene only when, and if, a true and focused conflict develops.

## II.

## THE DECISION OF THE COURT OF APPEALS CONFORMS WITH THE LANGUAGE AND LEGISLATIVE HISTORY OF SECTION 12(2).

This Court should only review this case if there is evidence of a mistake that needs correction or an inequity that demands redress. Neither is present here. The Court of Appeals' interpretation of Section 12(2) is natural, uncontrived and fully supported by the language and legislative history of the 1933 Act.

### A. Section 12(2) Is Limited By Its Language To Misstatements Made In Connection With Initial Distributions.

By its terms, Section 12(2) applies only to those persons who offer or sell securities "by means of a prospectus or oral communication." 15 U.S.C. § 771(2).[6] As Legg Mason has

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6. Section 12(2) provides as follows: "Any person who — (2) offers or sells a security (whether or not exempted by the provisions of § 77(c) of this (Cont'd)

contended from the start, and as the Court of Appeals agreed, the use of the term "prospectus" to describe the written communications to which Section 12(2) applies makes clear that Congress intended to limit the section to initial offerings. As the court below concluded, "prospectus" in the context of the 1933 Act is a term of art which refers to the communication of information in initial distributions. 925 F.2d at 688. In support of their petition, the investors contend that the Court of Appeals erred in reading "prospectus" so narrowly. This contention is based entirely on a misinterpretation of the pertinent statutory language.

The term "prospectus" appears forty-two (42) times in the text of the 1933 Act. Section 2(10) — the section on which the investors rely exclusively to support their argument that "prospectus" means any "written communication" — defines only the form which a prospectus *may* take. As the substantive provisions of the 1933 Act demonstrate, however, a writing is not a "prospectus" merely because it takes on one of the forms enumerated in Section 2(10). Those documents which may, *in form*, constitute a prospectus are only, in fact, prospectuses if

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(Cont'd)
title other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security." 15 U.S.C. § 771(2).

used for the purposes set forth in Section 5.[7] If a document takes on one of the forms enumerated in Section 2(10) and fulfills the function set forth in Section 5, it must then comply with Section 10, which requires that the prospectus contain, with certain exceptions, the detailed information set forth in the registration statement. Even the investors would concede that Sections 5 and 10 deal exclusively with initial distributions. Since "prospectus" is functionally defined by Sections 5 and 10 to concern only initial offerings, it simply cannot have been intended to include documents outside the context of an initial offering. Indeed, if Congress had intended "prospectus" to mean any "written communication", as the investors now suggest, it would have said so.

It follows that the phrase "or oral communication" in Section 12(2) must be similarly limited to the context of initial distributions. Since the phrase "oral communication" is not defined in the Act, it must be understood "in light of the words that accompany it and give [it] meaning". *Massachusetts v. Morash*, 490 U.S. 107, 115 (1989). This Court has noted the importance of construing the meaning of one term in a phrase consistent with the other words in the phrase:

> [t]he maxim *noscitur a sociis*, that a word is known by the company it keeps, while not an inescapable rule, is often wisely applied where a word is capable of many meanings in order to avoid the giving of unintended breadth to the Acts of Congress.

*Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 307 (1961). Applying this maxim to the plain meaning of "prospectus or oral

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7. For example, Section 2(10) expressly provides that documents sent to a buyer will *not* be deemed prospectuses, regardless of their form, if the buyer previously received the prospectus required by Section 5.

communication" in Section 12(2), the Court of Appeals correctly interpreted these words to mean that buyers may recover only for material misrepresentations made in a prospectus, or in an oral communication related to an initial offering. *Ballay*, 925 F.2d at 688.

In an effort to fit this case within the reach of *United States v. Naftalin*, 441 U.S. 768 (1979), the investors also labor to identify similarities between Section 12(2) and Section 17(a) of the 1933 Act. First, while Section 12(2) by its express terms applies only to one who offers or sells a security "by means of a prospectus or oral communication", Section 17(a) contains no such limitation. Indeed, Section 17(a) contains no reference to "prospectus" at all. Rather, Section 17(a) contains broad antifraud language almost identical to that of Section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder, which do, indeed, extend to secondary market trading. Second, this Court specifically noted in *Naftalin* that Section 17(a) represents a "major departure from [the] limitation" that the Securities Act of 1933 was primarily concerned with the regulation of new offerings of securities. 441 U.S. at 777-78. Unlike the legislative history of Section 12(2), (*see* Section II (B), *infra*), the legislative history of Section 17(a) explicitly demonstrates an intention to apply Section 17(a) to transactions in both the primary and secondary securities market. Finally, *Naftalin* did not involve a private action by an individual investor seeking monetary damages. *Naftalin* involved a criminal proceeding under Section 17(a)(1).

**B. Congress Did Not Intend Section 12(2) For Secondary Market Transactions.**

The legislative history, as well as the statutory language of Section 12(2), fully support the conclusion reached by the Court

of Appeals. In addressing the civil liability provisions of Sections 11 and 12 of the 1933 Act, the House Committee first stated:

> The committee emphasizes that these liabilities attach *only* when there has been an untrue statement of material fact or an omission to state a material fact *in the registration statement or the prospectus* — the basic information by which the public is solicited.

H.R. Rep. No. 85, 73d Cong., 1st Sess. (1933) at p. 9 (emphasis added). The House further observed:.

> [Sections 11 and 12] entitle the buyer of securities sold upon *a registration statement* including an untrue statement or omission of material fact, to sue for recovery of his purchase price, or for damages not exceeding such price, those who have participated in such *distribution* either knowing of such untrue statement or omission or having failed to take due care in discovering it.

*Id.* (emphasis added). The House concluded that the Act "throws upon originators of securities a duty of competence as well as innocence which the history of recent spectacular failures overwhelmingly justifies." *Id.* Congress could not have been clearer in stating its intentions with respect to the limits of Section 12(2).

Consideration of Section 12 in the larger legislative scheme of the 1933 Act fully supports this conclusion. Even the investors would not dispute that the 1933 Act was intended primarily to protect the public from unscrupulous issuers, underwriters and distributors of newly issued securities and to rid the marketplace of worthless investments. The Act sought to accomplish this by

encouraging the free flow of information to potential investors, and to ensure the accuracy of this information it imposed both significant obligations and severe sanctions on those with superior knowledge of the material facts regarding the worth of such securities. Recognizing that issuers, underwriters and distributors of new issues possessed both a complete monopoly on investment information and a significant financial incentive to withhold such information from the investing public, the drafters of the 1933 Act countered with substantial and very one-sided disclosure obligations and severe penalties for failure to satisfy these obligations. In turn, realizing that buyers of such new issues would have almost no opportunity to become informed about securities from any other source, the drafters placed no obligation on them to do so. Section 12(2), which makes sellers virtual insurers of the information they communicate to potential investors and provides defrauded purchasers with rescissory damages, is perfectly consistent with this legislative scheme.

In the context of initial offerings, where the flow of information is one-sided and the incentive to withhold is great, such a claim is easily justified, if not demanded. In the secondary market, where buyer and seller deal at arm's length often in faceless transactions over national exchanges, the security is well known to the marketplace and the financial incentive of research analysts such as Batten to prefer one security over another simply does not exist, the same type of claim has no place. Both parties to the transaction should have at least some obligation to keep abreast of publicly available information, and only intentional or reckless misstatements or omissions of the kind which Section 10(b) of the 1934 Act is designed to punish should justify liability.

**C. The Expansion Of Section 12(2) To Secondary Market Transactions Would Lead To Unreasonable Results.**

For more than four decades, Section 10(b) of the 1934 Act

has offered a private cause of action for misstatements in the secondary market. *See, e.g., Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946). During that time, Section 10(b) has been the subject of considerable jurisprudential development and the standards for liability under that section have been carefully defined. The extension of Section 12(2) and its much less stringent standards of liability to the misconduct currently governed by Section 10(b) would effectively overrule 40 years of precedent with respect to scienter, reliance and loss causation.[8] An investor can recover under Section 12(2) simply by showing that the defendant (1) offered or sold a security by means of a prospectus or oral communication, (2) misstated or failed to state a material fact, and (3) knew or should have known of the untruth or omission while the investor did not know of the untruth or omission. *Monetary Management Group, Inc. v. Kidder, Peabody & Co.*, 615 F. Supp. 1217, 1221-22 (E.D. Mo. 1985). He need not prove scienter, reliance or loss causation.[9] Extending Section 12(2) to secondary market transactions would bring about the virtual extinction of Section 10(b). It would also be inconsistent

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8. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) (under Section 10(b) a plaintiff must establish, *inter alia*, that the defendant acted recklessly or with an intent to deceive known as scienter); *Sharp v. Coopers & Lybrand*, 649 F.2d 175 (3d Cir. 1981), *cert. denied*, 455 U.S. 938 (1982) (Section 10(b) imposes upon the plaintiff a stringent reliance requirement); *Sims v. Faestel*, 638 F. Supp. 1281 (E.D. Pa. 1986), *aff'd*, 813 F.2d 399 (3d Cir. 1987) (the plaintiff in a Section 10(b) claim must establish a direct causal relationship between the alleged misrepresentation and the loss).

9. *See* L. Loss, *Fundamentals of Securities Regulation*, 892 (2d Ed. 1988) (Section 12(2) is limited to "*intentional* or *negligent* misstatements or omissions) (emphasis in original); *Woodward v. Wright*, 266 F.2d at 116 ("[t]o say that purchaser reliance is a prerequisite to seller liability is to import something into the statute [12(2)] which is not there"); *Hill York Corp. v. American International Franchises, Inc.*, 448 F.2d 680, 696 (5th Cir. 1971) ("[a] causation test should not be read into [Section (12(2)]").

with *Hochfelder, supra*, in which this Court held that Congress intended otherwise in enacting Section 10(b).

The investors, apparently understanding the significance of the radical departure from *Hochfelder* implicit in their position, contend that it is simply the converse of this Court's holding in *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983). In *Huddleston*, this Court held that purchasers with claims under Section 11 for untrue statements in registration statements may also seek recovery under Section 10(b) of the 1934 Act. *Id.* at 387. As the Court noted, its holding did not affect the standards for liability under Section 11 or impact the continuing vitality of Section 10(b). What the investors seek in this case — the elimination of an existing Section 10(b) claim, with its higher standards of liability, by the substitution of Section 12(2) with its lower standards — is clearly not supported by anything in *Huddleston*.

The investors' interpretation of Section 12(2) also lacks any semblance of logical consistency. For example, if adopted, their interpretation would inexplicably create new remedies for defrauded buyers that, by the language of Section 12(2), cannot extend to defrauded sellers. While both defrauded buyers and defrauded sellers may recover under Section 10(b), "[a] defrauded seller has no cause of action under section 12(2)". *Hoxworth, supra*, at 203 n. 25. In the context of initial offerings, the obvious contrast between an acute concern for defrauded buyers and the absence of *any* civil damage remedy for defrauded sellers makes complete sense. Only purchasers can be injured by misinformation in an initial offering context. In the secondary market, where defrauded sellers may, in fact, even outnumber defrauded buyers, it makes no sense at all.

This differentiation between defrauded sellers and defrauded buyers becomes even more apparent when one considers the

different remedies available under the two statutes. Under Section 10(b), a defrauded buyer's only remedy is "actual damages". 15 U.S.C. § 78bb(a). Under Section 12(2), on the other hand, the defrauded buyer is entitled to a rescissory measure of damages equal to the difference between the price he paid for the securities and the price at which they were sold. *Randall v. Loftsgaarden*, 478 U.S. 647, 655-56 (1986). The difference is, of course, that under Section 12(2) a defrauded buyer can recover not only the loss created by the misrepresentation but the intervening market losses as well, without any proof of scienter, reliance or loss causation. Under the investors' version of Section 12(2), even if the defrauded seller had proven each of those elements, he would still receive as compensation only his out-of-pocket loss. As the Court of Appeals recognized, such differentiation represents a drastic and unjustified departure from the even-handed judicial development of the federal securities laws.

The investors also argue that unless Section 12(2) is extended to misstatements in secondary market transactions the remedies provided by Section 11 and Section 12(2) will be redundant. This is simply not true. Section 12(2) governs transactions and parties outside the scope of Section 11. In particular, Section 11, by its terms, governs only defects in registration statements and provides no protection for initial offerings not subject to the registration requirements of the 1933 Act. Section 12(2), on the other hand, protects persons who purchase registered or unregistered securities in an initial distribution. Additionally, Section 11 imposes liability only on particular persons directly involved in the issuance such as signers of the registration statement, the directors of the issuer, and the underwriters. Section 12(2), on the other hand, establishes liability for "any person who offers or sells a security . . . . " Lastly, by the specific language of Section 10(b) of the 1933 Act, Section 11 is wholly inapplicable to prospectuses. 15 U.S.C. § 77j(b). By contrast, Section 12(2) covers both prospectuses and oral statements related to initial offerings, a category of

misstatements that is not even addressed in Section 11. Section 12(2), properly understood, does not merely duplicate the remedies available under Section 11.

Finally, the investors suggest that unless Section 12(2) is expanded to include the secondary market, injured buyers of securities in that market will be left without an adequate remedy for their loss. This is simply not the case. Those who have been victimized by fraud, misrepresentation or even reckless misstatements in connection with a secondary market transaction are not without recourse. They may, like the investors in this case, assert a claim under Section 10(b) of the 1934 Act. They may also pursue their rights under the common law through claims such as negligence, fraud and breach of fiduciary duty. As the Court of Appeals properly recognized, the creation of an additional remedy through an expanded application of Section 12(2) would be both unnecessary and unjustified.

## CONCLUSION

Based on the foregoing, it is respectfully submitted that the investors' petition for a writ of certiorari should be denied.

Respectfully submitted,

C. CLARK HODGSON, JR.
DAVID C. FRANCESKI, JR.
KEITH R. DUTILL
STRADLEY, RONON, STEVENS & YOUNG
*Attorneys for Respondent*